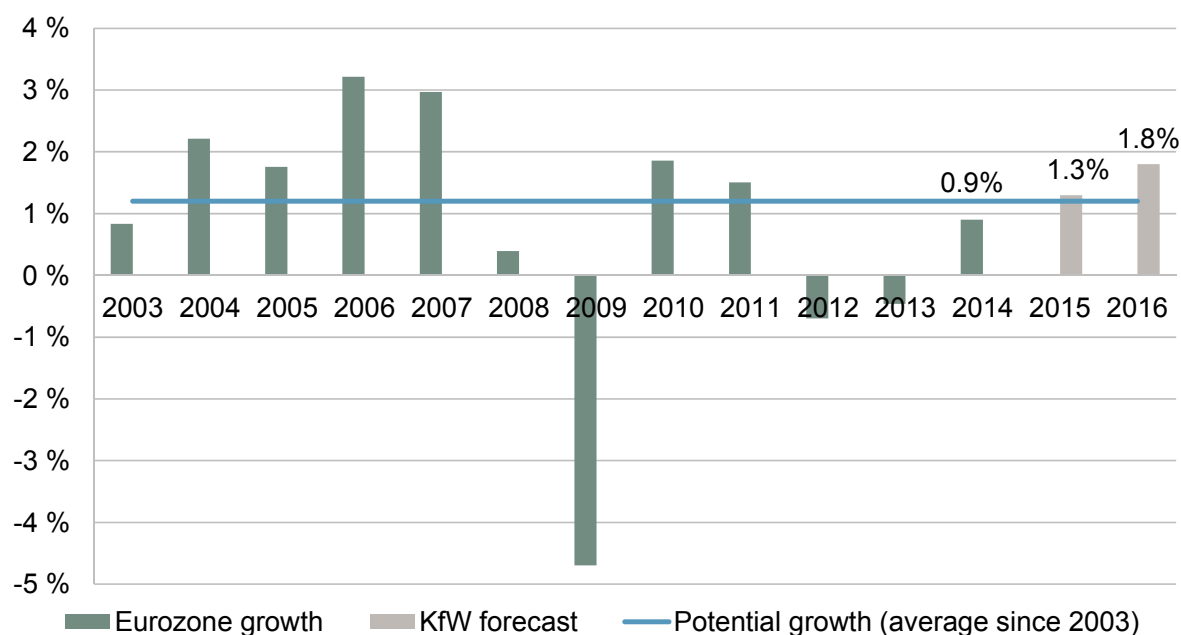


KfW Business Cycle Compass Eurozone

Broad-based growth in the Eurozone

- *Seasonally adjusted gross domestic product in the Eurozone grew by 0.4% in real terms during the first quarter of 2015.*
- *For the first time since 2010, all of the five largest member states contributed to the growth figures.*
- *KfW Research expects growth of 1.3 and 1.8% for 2015 and 2016 respectively.*

Real gross domestic product growth in the Eurozone



Source: AMECO, KfW Research

Recovery on a firmer footing

Growth in the Eurozone accelerated somewhat at the start of 2015. Seasonally adjusted gross domestic product (GDP) expanded at a rate of 0.4% in real terms during the first quarter of 2015, having already grown by 0.3% in the final quarter of 2014. This means that the recovery is on an increasingly firmer footing: For the first time since 2010, all of the major economies – Germany, France, Italy, Spain and the Netherlands – contributed to the growth.

As in the previous quarter, growth at the start of the year was driven by domestic demand. Overall, domestic expenditure components of GDP contributed 0.7 percentage points towards the growth figure, while net exports held growth back somewhat, primarily because of strong demand for imports.

The positive signs in terms of domestic demand are a reflection of improvements on the labour market. Since the start of 2015, the unemployment rate in the Eurozone has dropped by 0.3 percentage points to 11.1%. The largest falls were in the crisis-hit economies of Portugal, Ireland and Spain.

Improved economic conditions

This encouraging development comes primarily on the back of improved economic conditions within the Eurozone. Companies are currently reaping the benefits of a weak currency and low oil prices are boosting consumer spending attitudes. The drag created by fiscal policy has also subsided to some extent. After having achieved considerable reductions in their average structural budget deficit over the last five years, the Eurozone's member states have now chosen a largely neutral fiscal policy stance: At 0.9% of GDP, the European Commission expects the structural deficit in 2015 to remain largely unchanged compared with the previous year's figure of 0.8%.

Growth has its limits

We expect the favourable economic conditions to continue largely unchanged until the end of our forecast horizon but this does not mean that growth will continue indefinitely. By and large, the results from the first quarter and the current trend in business sentiment indicators are in line with our expectations. As a result, we have not changed our 2015 full-year forecast, which remains at 1.3%. We are also sticking to our growth forecast of 1.8% for 2016, placing us slightly below the average figure put forward by other forecasters. This is mainly a result of our slightly sceptical estimation of the growth prospects for Germany; we expect GDP growth of 1.5 and 1.8% in 2015 and 2016 respectively, which again places our forecast slightly below the average. In addition stubbornly high unemployment and ongoing efforts to reduce high levels of debt in the public and private sectors are both obstacles to stronger growth in the Eurozone. Growth in the global economy has also been slow at the start of the year. At present, the Eurozone's economy is still too dependent on low interest rates and a weak currency to be able to withstand the effects of a deterioration in the global economic environment.

Mainly upside risks

Our forecast involves mainly upside risks. Pleasant surprises may come from a number of areas, for example exports. If the full impact of depreciation in the value of the euro feeds through to foreign demand, our current expectation is that exports will strengthen slightly at the end of the year. A sharper rise in exports would speed up the recovery of the labour market and result in second-round effects that would boost consumer spending and private investment. Greece remains the great unknown in terms of downside risk. In our projection, we have assumed that a last minute deal can be brokered that keeps Greece in the Eurozone.

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